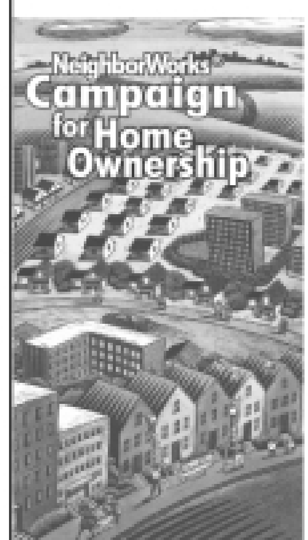
NeighborWorks
AMERICA

Effective Community-Based Strategies for Preventing Foreclosures

September 2005



NEIGHBORWORKS® AMERICA,
THE NEIGHBORWORKS® NETWORK AND
THE NEIGHBORWORKS® CAMPAIGN FOR HOME OWNERSHIP

Neighborhood Reinvestment Corporation, doing business as NeighborWorks® America, was established by an act of Congress in 1978 (Public Law 95-557). A primary objective of NeighborWorks® America is to increase the capacity of local community-based organizations to revitalize their communities, particularly by expanding and improving housing opportunities.

These local organizations, known as NeighborWorks® organizations, are independent, resident-led, nonprofit partnerships that include business leaders and government officials. All together they make up the NeighborWorks® network.

The NeighborWorks® Campaign for Home Ownership is the largest national initiative of its kind: a joint effort by private industry and government working with community-based NeighborWorks® organizations to bring more families into homeownership. NeighborWorks® organizations participating in the campaign use the NeighborWorks Full-Cycle Lending® system. Under this system, prepurchase education, innovative loan products and early-intervention delinquency counseling are combined into a system that helps create successful homebuyers who take charge of their neighborhoods as well as their homes.

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Executive Summary

Creating homeownership is a central strategy of community developers, but the success that they have realized is threatened by a recent rise in the rate of mortgage foreclosures. Innovations in the mortgage industry, particularly automated underwriting, risk-based pricing and stratified securitization, have helped foster the development of mortgage products that are flexible and affordable, expanding homeownership opportunities to many households with poorer credit ratings and fewer savings for down payment. But these riskier “subprime” loans, often made with larger up-front fees and higher interest rates, are foreclosed upon at a much higher rate than are prime loans. Subprime lending has also been concentrated in low-income and high-minority areas, often the very places community developers are trying to revitalize.

Mortgages go into default, the first step toward foreclosure, for a variety of reasons. Research on mortgage risk has shown that the equity in the home is the most important determinant of the likelihood of mortgage default, demonstrating the risk inherent in low-down payment mortgages and in borrowing against home equity for consumption. In addition, life events such as job loss, divorce or illness may cause a household to fall behind on mortgage payments. Properties located in low-income and high-minority areas also show a great propensity to default, even controlling for other factors.

Opportunities for owning a home have increased with the rise of subprime lending (loans offered to generally less creditworthy borrowers at higher costs). Subprime loans default at a much higher rate than prime loans, however. Some studies have linked increases in subprime lending in certain areas with increases in foreclosures there.

Community-based development organizations across the country have responded to the increase in foreclosures by providing counseling and loans and by working with local lenders to minimize the number of delinquent mortgages that go into foreclosure. Foreclosure-prevention programs are resource-intensive, however, and community organizations in locations with high foreclosure rates can be quickly overwhelmed by requests for assistance. Nevertheless, many affiliates of the NeighborWorks® network have created successful programs. These programs have staff with a wide variety of experience, as they must negotiate with the lender and servicer staff, and also provide counseling and support to the homeowner. Counseling may be needed to cover a variety of topics, including financial education, household budgeting, job skills or family problems, and often requires partnering with other organizations. A number of the foreclosure-prevention programs also provide, or have access to, loans and grants to help homeowners restructure their debt and become current on their mortgages.

Two of the most sophisticated foreclosure-prevention programs are run by Neighborhood Housing Services of Chicago and NHS of New York City. NHS of Chicago’s target neighborhoods were experiencing a foreclosure rate of 7.7 percent, compared to a national rate of 1.2 percent. The number of foreclosures was rising quickly, and properties were going into foreclosure in a short time. Much of the increase in foreclosures was due to subprime lending, which had increased rapidly in Chicago and was particularly common in the target neighborhoods. In response, NHS of Chicago implemented the Home Ownership Preservation Initiative (HOPI), with the goal of helping 1,500 homeowners in danger of foreclosure to keep their homes. HOPI works with local subprime lenders on issues related to foreclosure, provides financial assistance through a $2.2 million loan program, and offers counseling to help homeowners get out of trouble.

Foreclosures are also on the rise in a number of the neighborhoods targeted by NHS of New York City. NHS of NYC has seen foreclosure rates in seven of its target neighborhoods that are more than twice the overall city rate. The target neighborhoods have also seen a 60 percent increase in the number of subprime loans in just two years. The organization's foreclosure-prevention program includes early-delinquency intervention, classroom training and one-on-one counseling, and financial assistance. NHS of NYC has developed partnerships with many national organizations to combat predatory lending and assist senior citizens who are having financial problems.

Advances in mortgage underwriting and securitization have allowed lenders to create products that have expanded homeownership opportunities. These products, often higher-cost subprime mortgages, carry a greater risk of default and foreclosure. As subprime loan originations increasingly concentrate in low-income and minority neighborhoods, so do foreclosures. The extension of riskier mortgages by lenders may be greater than revitalizing neighborhoods can withstand.

Combating Foreclosures as Part of a Neighborhood Revitalization Strategy

Creating homeownership opportunities is a central strategy of community development. Increasing homeownership in distressed areas stabilizes populations and housing markets, creates stakeholders for revitalization and builds the wealth of low-income households. Success has been demonstrated by increases in homeownership rates across the country and in targeted neighborhoods. These gains are threatened by a recent rise in foreclosure rates, however, a trend that has the potential to undo in a few years what has taken decades to achieve.

In recent years, lenders have introduced a number of innovative mortgage products that are affordable and flexible, providing access to mortgage capital for many more households. These innovative products have been made possible by the automation of the underwriting process and advances in mortgage securitization. Automated underwriting has allowed lenders to develop products with smaller down-payment amounts and higher loan-to-value ratios that can reach borrowers who have fewer saving. Stratified securitization has allowed for riskier mortgage products through risk-based pricing, distributing greater risk to investors in exchange for higher returns, generally paid for by higher interest rates on the mortgage.

Automated underwriting and advances in securitization have also allowed for the recent surge in subprime lending, loans made to riskier borrowers in exchange for greater up-front costs and higher interest rates. Subprime lenders increased their lending from $90 billion in 1996 to $375 billion in 2003. This riskier lending has been concentrated disproportionately in low- and moderate-income areas and in areas with a high proportion of African-American residents.

With this riskier lending has come a sharp rise in foreclosures in the subprime market. These foreclosures have also been concentrated disproportionately in lower-income and minority neighborhoods. The question becomes: can distressed neighborhoods withstand the risks that changes in mortgage financing have allowed?

This report begins by describing the foreclosure process, including mortgage default and the process for loan workouts. Section One then presents a review of the research on the various factors that lead to default and foreclosure. The rise of the subprime market and its relation to foreclosures is then described, using recent studies of subprime lending in selected cities and counties. Section Two examines the available data on foreclosures and identifies some trends in these data. Section Three describes a number of community-based responses to foreclosures and includes a review of an analysis of several community-based foreclosure-prevention programs. Finally, Section Four presents case studies of foreclosures and foreclosure-prevention programs in Chicago and New York City.

Section I: Foreclosure and Default

Foreclosures: Process, Costs and Loss Mitigation Options

The Foreclosure Process

While foreclosure laws vary in specifics from state to state, the foreclosure process generally follows a standard process. A mortgage agreement typically includes a provision for the borrower to make monthly payments on a given date. Once the mortgage is originated, responsibility for ensuring that cash flows reach their appropriate destination is given to what is known as the "servicer." The loan servicer may be the loan originator or another institution. The mortgage holder has contact with the servicer and sends the servicer the monthly payments.

The borrower is often charged a late fee for any payment that is 15 days late. If the borrower's payment is still unpaid by 30 days, the mortgage is said to be in default. The servicer will file a Notice of Default with local government authorities and send a letter to the borrower which states that the loan is in default and outlines steps that must be taken to make the loan current. Unless arrangements are made with the lender, the mortgage can then go into foreclosure.

When mortgage payments become 90 days late, the lender will generally begin a legal process against the owner in order to force the sale of the mortgaged property. The property may be sold at a public auction with the proceeds going to pay off the mortgage debt. If the property is worth less than the total amount owed on the mortgage, the lender could seek a deficiency judgment against the borrower. However, a few states — such as Alaska, Arizona and California — have strong anti-deficiency laws and lenders generally do not seek deficiency payments; in addition, the Federal Housing Administration generally does not seek deficiency payments on the loans it insures.

Costs of Foreclosure

Foreclosures are costly, particularly to mortgage insurers and guarantors, but also to other stakeholders, including loan servicers, local governments, neighboring homeowners and the mortgage holders themselves. Mortgage insurers lose the portion of the outstanding debt and resale costs that the sale of the foreclosed property does not cover, up to their maximum guarantee. In 1997, FHA reported average foreclosure losses of $28,000, while the VA reported average losses of $10,600; United Guaranty Corporation, a private insurer, reported an average loss of $17,300 on its foreclosed loans (McCarthy et al. 2001). Guarantors such as Fannie Mae and Freddie Mac realize losses from foreclosures through mortgages sold on the secondary market; one study (Moreno 1995) estimated that their average loss per foreclosed loan was between $6,400 and $8,000.

While other stakeholders are not hit as hard or as directly by foreclosures as the insurers and guarantors, nevertheless the impacts are real. Loan servicers lose the fee they are paid for each mortgage they are servicing that goes into foreclosure. Local governments lose property tax payments, at least temporarily, and they may also incur costs if they must maintain and dispose of the property. In addition, local governments can lose tax revenues from other properties nearby, as foreclosed properties can have a negative impact upon neighboring home values (Wiranowski 2003). Finally, the homeowners themselves lose their homes and whatever equity they had in them, and their credit record suffers for years to come.

When all costs to stakeholders are accounted for, one study estimates that foreclosures can cost upwards of $26,000 (McCarthy et al. 2001). With this strong incentive to avoid foreclosure, lending institutions are becoming more adept at loss-mitigation techniques. The success rate of loan workouts is now more than 50 percent of those loans that would have gone to foreclosure in the past (Capone 2002).

Loss Mitigation

The primary loss-mitigation alternatives to foreclosure are the following:

- *Loan modification:* A refinance without closing costs; this option works best when interest rates are low and the borrower cannot qualify for a full refinance, but is capable of regular mortgage payments. Some arrears may be included in a modified loan balance.
- *Special forbearance:* An extended repayment plan.
- *Preforeclosure:* After agreeing with the lender on a loss-sharing arrangement, the borrower sells the home. Borrowers are often allowed to pay back their loss share over time. Preforeclosure saves foreclosure costs and often fetches a higher price for the property.
- *Deed-in-lieu of foreclosure:* The borrower assigns title to the property to the lender without going through the foreclosure process, often with the borrower paid some cash inducement.
- *Partial claim:* An FHA tool in which FHA puts up funds to make the loan current with the servicer in exchange for a promissory note payable when the property is sold, to the extent there is equity in the property.

Loss-mitigation techniques have become more standardized in the industry, and the success of loan workouts has increased. As evidence of the success of loss-mitigation efforts, Cutts and Green (2004) cite data from the Mortgage Bankers Association’s National Delinquency Survey. During the 1990–91 recession, 1.5 million jobs were lost over four quarters, and foreclosure rates peaked at 0.83 percent; during the 2001–03 recession, 2.6 million jobs were lost, and foreclosure rates peaked at 0.56 percent. Cutts and Green conclude that recent changes in mortgage-servicing policies have helped keep delinquent borrowers in their homes, with low- and moderate-income borrowers who enter a repayment plan realizing a 68 percent reduction in the likelihood of home loss.

Research on Foreclosures and Defaults

Lending of any type involves the risk that the loan may not be repaid, and much of the research on mortgages has assessed the factors that may lead to default or foreclosure. This research has focused upon homeowner “incentive” to default on loans, and often uses multipliers to determine relative risk. Researchers have concluded that a household “decides” to miss a mortgage payment or go into foreclosure based on an assessment of its current financial situation. This assessment takes into account what members of the household have to lose — the equity in the home — and other financial obligations such as consumer debt or medical bills.

Equity and Down Payments

Most research has considered borrower equity the most important determinant of default. When a household has less to lose from foreclosure, it is more likely to default on its mortgage. Many new mortgage products allow for smaller down payments, such as three or five percent down, and in some cases mortgage products require no down payment at all. While these products have allowed low-wealth households to own homes, they also carry greater risks.

One review of the early performance of loans made specifically to promote affordable homeownership compared early delinquencies of special affordable-housing loans with the longer-term claim rates of standard loans with relaxed underwriting (Steinbach 1995). The analysis found that early delinquencies were twice as high for three percent down payments compared to five percent down payments, and that reducing down payments from ten to five percent doubled claim rates in the longer term (five to ten years). Conversely, a study of USDA loans for low-income rural households made through the Farmers Home Administration (FmHA) found that those who generated sweat equity by building their own homes had a nearly 75 percent reduction in the probability of monthly default (Quercia et al. 1995).

Using a home-equity loan to borrow against a property can reduce the equity in the home. The level of borrowing through home-equity loans has been on the rise in recent years, both in the total dollar amount of loans and the size of each loan, and much of that increase has occurred in the subprime market (LaCour-Little 2004). One estimate put the home-equity market at $50 to 100 billion in the mid-1990s, compared to $525 to $700 billion by 2000 (LaCour-Little 2004), an increase of about 800 percent. Since then, home-equity borrowing has continued to grow, with one estimate putting the increase from 2000 to 2001 at 19 percent and from 2001 to 2002 at 22 percent, with growth expected to continue at approximately that pace (SMR Research 2003, 2004). Furthermore, the size of new home-equity loan commitments increased by 44 percent from 2002 to 2003 alone, to an average of $58,054; 16 percent of these loans went to subprime borrowers (American Banker 2003).

Increasing housing prices is fueling much of the growth in home-equity borrowing. But as home prices have risen, so has consumer debt. The ratio of household debt payments (mortgage and consumer debt) to disposable income increased to a record high of 13.27 in the fourth quarter of 2001 and then dropped to 12.98 in the first quarter of 2004, a rate that is still higher than anything seen prior to 2001 (Peterson 2004). Borrowing against one's home, even as housing prices increase, may increase the chance of foreclosure. One study has found that housing appreciation may encourage home-equity borrowing and thereby actually increase the risk of default (LaCour-Little 2004).

Home-equity borrowing is not considered a factor in increasing the risk of foreclosure as long as the money is used for home improvement rather than for consumer spending. Home improvements should increase the value of the home and retain equity. When cash is taken out for other purposes, however, equity declines and the risk of default and foreclosure increases.

Trigger Events and Consumer Debt

Research on the causes of mortgage default has also highlighted the importance of crisis events, sometimes called "trigger events," in predicting default. An early study (Gardener and Mills 1989) found that personal financial circumstances, most frequently job loss or reduced income, were the causes of default in three-quarters of all cases examined. Other causes cited were divorce, illness or death, legal problems and catastrophes. Another study has shown that adverse shocks to house prices and income play a central role in mortgage default (Elmer and Seelig 1999). A more recent examination of delinquent borrowers also cited job or income loss as the primary event that cause a household to fall behind in mortgage payments, accounting for 39 percent of all delinquencies; other trigger events include illness or death (16 percent), excessive obligation (10 percent) and marital difficulties (9 percent) (Cutts 2003).

Low-income and minority households may be more likely to experience trigger events, particularly job loss. Job separation rates tend to be much higher in at least two industries — leisure and hospitality and construction — where lower-income workers are more likely to be represented than in other industries. In August 2004, the separation rate for all industries was 3.1 percent, compared to 6.2 percent for the leisure and hospitality industry and 5.6 percent for construction (BLS 2004). Moreover, job displacement among African-Americans has risen sharply in recent years, from 4.2 percent in the1997 to 1999 period to 7.3 percent in the 2001 to 2003 period, compared to an increase from 4.0 to 5.6 percent for white workers (Schmitt 2004).

Property Location

In addition to borrower characteristics, researchers have examined the characteristics of the neighborhoods in which properties are located. In much of the research, characteristics of the census tract in which the property is located, particularly minority composition and income, have been found to be more important in determining default rates than borrower characteristics (Van Order and Zorn 2001). For example, one study found that default rates for properties in very-low-income census tracts are double those for very-low-income households (Van Order and Zorn 2000).

Another study of 22 metropolitan areas found that neighborhood effects on default persist even when taking into account individual borrower- and loan-related factors (Cotterman 2001), and that neighborhood characteristics, particularly race and income, have effects on default rates that are separate and distinct from these same characteristics at the individual level. Cotterman suggests that earlier defaults may act as a trigger for later defaults, which may arise because defaults result in vacant properties or because they are one component of undesirable turnover in neighborhood homeownership. Analysis by Collins (2003) suggests that there is a "contagion" effect, demonstrating that foreclosures in some Chicago neighborhoods have tended to cluster, positing that a number of geographically concentrated foreclosures may cause additional foreclosures in that area.

Subprime Lending

The influence of property location on default rates may be related to the rise of subprime lending, which tends to concentrate its lending activities in low-income and minority areas. Subprime lenders offer loans to generally less-creditworthy borrowers at a higher cost, through higher interest rates, higher closing costs, or both. Subprime lending and risk-based pricing have provided opportunities for less-creditworthy borrowers to purchase homes and to realize the benefits of homeownership.

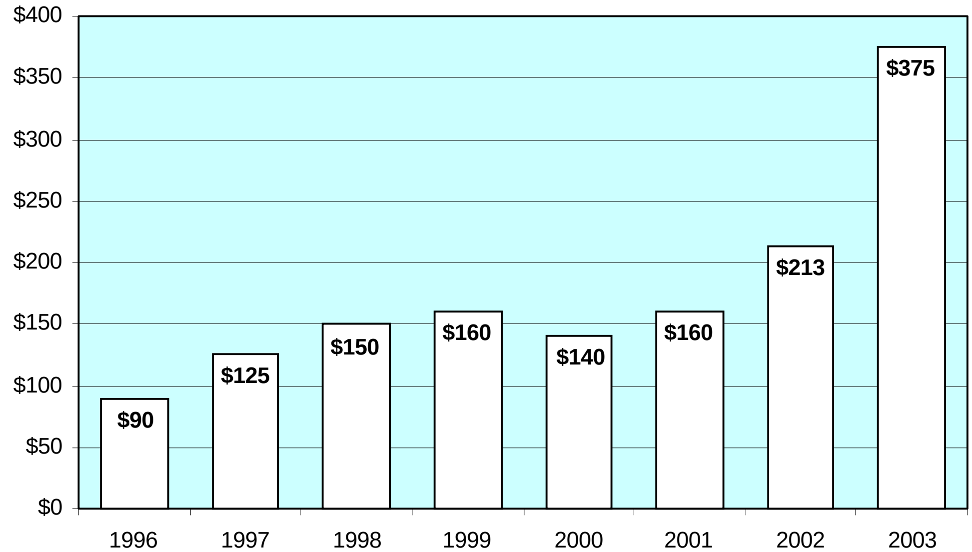
However, risks in mortgage lending are not necessarily properly priced, and the subprime industry may not be regulated for maximum benefit (Collins et al. 2004). One primary problem with the subprime market is the lax regulation of third-party brokers, the most common originators of subprime loans (Apgar et al. 2004). Third-party brokers are primarily concerned with making loans, and not necessarily with assuring that the loans are viable or the best deal possible for the customer. In fact, Fannie Mae has estimated that as many as 35 to 50 percent of all subprime borrowers could have qualified for lower-cost prime loans (Carr and Schuetz 2001).

Subprime lenders also have been linked to predatory-lending practices (Bunce et al. 2001), when borrowers are victims of deception or outright fraud. While certainly not all subprime loans are predatory loans, both subprime and predatory loans charge interest rates that are higher than conventional rates and that require larger up-front payments. In addition, anecdotal evidence is growing that a subset of subprime lenders are engaging in practices that strip borrowers of home equity, thereby placing them at greater risk of foreclosure (HUD/Treasury 2000).

The Growth of Subprime Lending

Subprime lending has grown significantly in the past few years: while the volume of subprime loans increased by 77 percent between 1996 and 2001, it jumped an additional 235 percent in just the next two years, from $160 billion to $375 billion (Freddie Mac 2004). According to the national advocacy group ACORN, there were just over 100,000 subprime loans in 1993 compared to more than a million subprime loans in 2001 (ACORN 2002). About two-thirds of all subprime loans are refinances, and most involve taking cash out, thus reducing the home owner's equity (Apgar et al. 2004).

Figure 1: Subprime Lending Activity in the U.S.: 1996–2003 (in billions of dollars)



Source: Freddie Mac 2004.

A number of recent studies that have examined subprime lending in selected cities and counties have demonstrated the rapid growth of the industry and its focus on low-income and minority neighborhoods. In the Atlanta metro area, loan originations by subprime lenders grew 150 percent between 1994 and 1998, compared to an overall growth in originations of 111 percent; in very-low-income neighborhoods (where median household income is less than 50 percent of the metro area median), the growth rate was 440 percent, and in neighborhoods with more than 50 percent minority population, the growth rate was 317 percent (Abt 2000a). The growth of subprime lending in Boston was even greater during the same period: subprime loan originations grew by 435 percent compared to a total origination growth of 119 percent; subprime lending grew 1,075 percent in very-low-income neighborhoods and 1,005 percent in minority neighborhoods (Abt 2000b).

Similar trends were found in Baltimore, Los Angeles, Chicago and Philadelphia (HUD 2000a, HUD 2000b, HUD 2000c, Goldstein 2004). These studies consistently found that subprime loans were much more likely in low-income and minority neighborhoods than in upper-income and predominantly white neighborhoods. Further, the growth in subprime lending they cite occurred by 1998, prior to the large increases described above.

Table 1: Subprime Lending Characteristics in Baltimore, Los Angeles and Chicago, 1993 and 1998

	# of Subprime Refinance Loans 1993	*# of Subprime Refinance Loans 1998*	*Percent Change 1993–98*	*Ratio of Loans in Lower-income to Upper-income Neighborhoods**	*Ratio of Loans in Black to White Neighborhoods***
Baltimore	555	8,268	1,390%	7.4 to 1	6.1 to 1
Los Angeles	9,351	25,384	171%	2.1 to 1	3.7 to 1
Chicago	1,582	27,470	1,636%	6.2 to 1	6.0 to 1

* Ratio of subprime refinance loans in predominantly low-income neighborhoods to similar loans in upper income neighborhoods, 1998.

** Ratio of subprime refinance loans in predominantly African-American neighborhoods to similar loans in predominantly white neighborhoods, 1998.

Sources: HUD 2000a, HUD 2000b, Goldstein 2004.

Subprime loans, particularly for refinance, are more likely to be made in low-income and minority neighborhoods. In 1998, subprime refinances accounted for 26 percent of refinance loans in low-income neighborhoods, compared to 11 percent in moderate-income neighborhoods and 7 percent in upper-income neighborhoods (Bunce et al. 2001). As the studies cited above demonstrate, the differences are even more pronounced for predominantly African-American neighborhoods compared to white neighborhoods. Racial differences persist even when income is factored in: while only 6 percent of homeowners in upper-income white neighborhoods used subprime lenders, 39 percent of homeowners in upper-income African-American neighborhoods have used subprime refinancing, twice the rate of low-income white neighborhoods (Bunce et al. 2001).

A report by the Center for Community Change also highlights the disparities in subprime lending between white and minority households (CCC 2002). Using 2000 data on mortgage originations, CCC found that lower-income African-American households received 2.4 times as many subprime loans as lower-income white households, while upper-income African-American households received three times as many subprime loans as their white counterparts; the respective figures for Hispanic households were 1.4 and 2.2 (CCC 2002).

Subprime Lending and Foreclosures

Subprime loans are far more likely to be foreclosed upon than prime loans, and the recent increase in subprime foreclosures is staggering. The percentage of subprime loans going into foreclosure increased from a little over 3 percent in 1998 to more than 9 percent in 2002 before declining to about 7 percent in 2003; this compares to a foreclosure rate for prime loans over this period of about 0.5 percent (Apgar et al. 2004).

The growth rate of subprime foreclosures has far outpaced the growth rate of prime foreclosures. In the Atlanta metro area, subprime loan foreclosures increased 232 percent between 1996 and 1999, while total foreclosures declined 7 percent (Abt 2000a). During the same period, subprime foreclosures in the Boston metro area increased 255 percent while all foreclosures there declined 29 percent (Abt 2000b). For six counties in the Chicago area, while total foreclosures increased 73 percent during that period, subprime foreclosures increased by 476 percent (NTIC 2004). These subprime foreclosures, like subprime originations, are concentrated in minority and low-income neighborhoods (Bunce et al. 2001).

A number of studies have examined subprime lending and its relationship to foreclosures in selected cities and counties. A study done in Philadelphia found that subprime market penetration was greatest in low- and moderate-income areas, and suggested that this was due to a constrained access to credit for minority and lower-income populations (Goldstein 2004). The study also found that subprime loans lead to a vastly disproportionate share of all foreclosures, and that these foreclosures occur much more quickly than foreclosures on prime loans. In Baltimore, it was also found that subprime lending is more prevalent in lower-income and minority neighborhoods and that the subprime share of foreclosures is highest in those neighborhoods as well (HUD 2000a).

Time to Foreclosure for Subprime Loans

Subprime loans also tend to foreclose more quickly than prime loans. In Philadelphia, 37.8 percent of subprime loans closed within two years of origination in 2001, compared to only 6.5 percent of prime loans (Goldstein 2004). Citing studies of the Atlanta, Boston and Chicago metro areas, Bunce et al. (2001) found that most subprime loan foreclosures occurred within two years of origination. In Baltimore, HUD found that loans by subprime lenders were on average 1.8 years old at the time the foreclosure petition was filed (HUD 2000a). Such short time periods between origination and foreclosure suggest that these loans may not have been viable at the time they were made. The capacity to prevent delinquency from emerging is reduced, as there is much less time to identify and remedy the problem.

Summary

The likelihood of mortgage default increases as equity in the home declines, and default may be triggered by life events that affect income and debt, such as job loss, illness and divorce. Lack of equity can be the result of a low down payment, a loan against the home for consumption expenses, or a decline in the value of the home; decline in home value may be due to declines in local housing values or to physical deterioration of the home. The effect of property location on the potential for default may be a consequence of the nature of the subprime market. Foreclosure rates are higher in low-income and minority neighborhoods, the same types of neighborhoods where subprime lending is concentrated.

Subprime and predatory lending often strip equity from a home and create repayment terms that are difficult or impossible for the homeowner to meet. Difficult repayment terms may be handled successfully with careful debt management practices, a restructuring of the debt or an increase in income. However, predatory, and even subprime, lending can put people into untenable financial situations, evidenced by the short time between origination and foreclosure for many subprime loans. The primary incentive for mortgage brokers is to close the deal, so they may tend to be less concerned with the long-term performance of the loan; in fact, the mortgage origination system is not structured to ensure that borrowers get the best terms for which they qualify (Apgar et al. 2004). Advances in mortgage underwriting and securitization allow lenders to originate higher-risk loans by charging more for the loan.

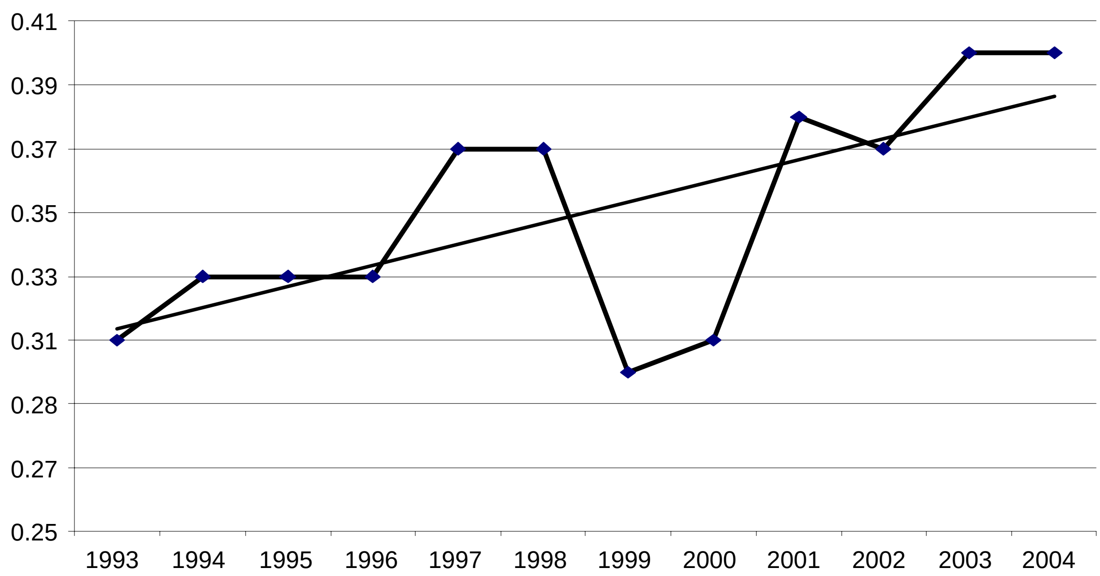
However, lending risk is not borne solely by the lending institution, the investors or the mortgage insurer. Mortgage foreclosure also impacts the community in which the property is located. It is likely that there is some contagion effect whereby concentrated foreclosures cause additional foreclosures in the community, perhaps by affecting vacancy rates and housing prices. For communities in the midst of revitalization, whose housing markets may not be very stable, increased foreclosures can undo the positive effects of increased homeownership on neighborhood sustainability. The risk of default or foreclosure that lenders can take on when making loans may be greater than the amount of risk revitalizing neighborhoods can withstand.

Section II: Trends in Foreclosures

Recent Trends in Foreclosures

National foreclosure rates have been rising slowly over the past decade, as can be seen by the trend line in Figure 2. In addition, the national 90-day delinquency rate for single-family homes doubled, from 0.39 in 1999 to 0.78 in 2003 (Freddie Mac 2004).

Figure 2: Rate of Foreclosures Started, 1993–2004, with Trend Line



Source: Freddie Mac, Reporter's Fact Book, 2004.

National foreclosure rates mask what is happening in local markets, however. A number of states are seeing much higher foreclosure rates than the national average. Three states had foreclosure inventories more than twice the national rate: Ohio, Indiana and South Carolina (Table 2). These three states also had the highest rate of subprime foreclosures in inventory.

Table 2: Rate of Foreclosure Inventory for All Loans and Subprime Loans, for Top 10 States and U.S. Overall, June 2004

	Foreclosures — All Loans	*Foreclosures — Subprime*
1. Ohio	3.33	11.57
2. Indiana	2.78	9.58
3. South Carolina	2.46	10.91
4. Mississippi	2.27	8.67

5. Kentucky	2.00	9.05
6. Pennsylvania	1.94	7.88
7. Oklahoma	1.83	6.61
8. Louisiana	1.73	6.81
9. Michigan	1.65	7.62
10. North Carolina	1.56	7.53
U.S. Total	1.16	4.61

Source: Mortgage Bankers Association.

Ohio and Indiana have seen rapid increases in their foreclosure rates in recent years. While foreclosure rates in those two states stayed below 1.5 percent during the 1990s, they reached nearly 3 percent in Indiana and 3.5 percent in Ohio by the 2000s. Foreclosure rates can be particularly high for smaller geographic areas (although the availability of data is limited). For example, the estimated foreclosure rate in Chicago reached 5.2 percent in 2002 before dropping back to 4.5 percent in 2003.1 The number of foreclosures in Chicago nearly doubled between 1993 and 2002. More details on Chicago's foreclosure problems are described in the case study below.

Aside from the data cited above, some foreclosure trend data are available for three New York counties, New York City and three Ohio counties, described below. These data on foreclosures cover different time periods and use differing measures, but are useful for examining trends in these selected areas.

The three New York counties — Nassau, Suffolk and Westchester — were examined by Abt Associates in a study of subprime lending and foreclosures (Abt 2002). Analysis of foreclosure auction sales from 1998 to 2001 in these three wealthy counties shows an increase both in subprime lending and in foreclosures, particularly in Suffolk and Westchester counties. The number of foreclosure sales increased 130 percent in Westchester, 113 percent in Suffolk and 35 percent in Nassau during the study period. The increase was particularly strong for subprime lenders, with subprime foreclosures increasing 285 percent, 174 percent and 47 percent, respectively.

In New York City, data from the Furman Center for Real Estate and Urban Policy at New York University shows substantial increases in foreclosures in two of the three boroughs for which sufficient data were available. In the Bronx and Brooklyn, foreclosure rates increased 45 and 43 percent, respectively, between 2000 and 2003, and increased 15 percent in Queens. More detail on foreclosures in New York City is provided in the case study below.

Foreclosures in Ohio were examined for Lorain (outside Cleveland), Summit (including Akron) and Montgomery (including Dayton) counties and were compared to state levels (Bellamy 2002). Foreclosures in Ohio, the hardest-hit state, increased 98 percent between 1997 and 2001, while foreclosures in these three counties increased 177 percent. Most of the increase came from subprime loans: there was a 333 percent increase in subprime foreclosures compared to a 120 percent increase in prime loan foreclosures (Bellamy 2002).

Section III: Community and Industry Responses to Foreclosures

In response to the growth of foreclosures, many community-based development organizations are establishing foreclosure-prevention and -intervention programs. While their primary concern is with the impact foreclosures may have on their community revitalization efforts, they also seek to sustain the gains in affordable homeownership that have been realized in recent years. Thus, while some CBDOs focus their foreclosure-prevention programs on targeted neighborhoods and clients whom they have helped get into homes, others accept applicants from wider geographic areas.

NWA has described a number of foreclosure-prevention programs among members of its NeighborWorks® network in its Winning Strategies database, available at www.nw2.org/WinningStrategies/search.asp.

It is useful to examine a number of these programs and consider what practices have made them successful. In addition to these descriptions, two in-depth case studies of foreclosure problems and foreclosure-prevention programs in Chicago and New York also help to illustrate how community-based responses have developed.

Neighborhood Housing Services of Boise

NHS Boise was established in 1982 to focus revitalization efforts on one Boise neighborhood; it has since grown into a multifaceted housing and social-service agency that offers many services statewide. As a NeighborWorks Full-Cycle Lender®, it provides both pre- and postpurchase counseling and housing and rehabilitation finance. It has developed more than 250 units of affordable rental property and 80 units for ownership. Annually, NHS Boise's homeownership programs help more than 300 households and leverage about $35 million with its first and second mortgages.

In 2002, NHS Boise established its foreclosure-prevention program in response to the eight to ten calls per month it was receiving from homeowners in danger of foreclosure. NHS Boise staff contacted local real estate agents and lending institutions to have them refer to the program homeowners who had gotten behind in their mortgage payments. With a grant from NWA, NHS Boise set up a program that includes an oversight committee, one-on-one counseling, loan funds and a marketing effort.

A subcommittee of NHS Boise's loan committee has developed guidelines for its foreclosure-prevention lending, with the committee determining who among the many applicants meets these strict lending criteria. The funds are available only to borrowers who can demonstrate that they are capable of repaying the loans and getting their mortgage payments back on schedule. The borrowers cannot have had a bankruptcy, and their delinquency must be due to some event outside their control, such as job loss or a medical emergency. They must be employed, earning less than 120 percent of the area median income, and demonstrate a strong desire to stay in their home. Loans from $1,500 to $5,000 are available at a four percent interest rate and a term that ranges from five to 15 years. The term of the loan is determined by capping the back-end debt ratio at 45 percent. Funds may only be used to pay off other debts once the mortgage is brought current. In addition, the first payment of the NHS loan may be deferred if the borrower requires more time.

The foreclosure-prevention program is available to homeowners throughout the state, but NHS Boise does not market it, for two reasons. First, the organization receives enough calls from those in danger of foreclosure as a HUD-approved housing counseling agency; it has also supplied local lenders with information about its program and receives a number of referrals from its lending partners and local real estate agents. As there have been major layoffs at some of the larger employers in the Boise area, the organization is now receiving 15 to 20 inquiries per week. Second, its foreclosure-prevention activities are costly and use a great deal of staff time. Each loan requires an average of nine hours of counselor time and costs NHS an average of $906.

NHS Boise has closed nine loans, averaging $4,400 per loan. The borrowers who received these loans had all experienced job loss, but all were rapidly able to become current again on their mortgages because of the loan. The organization plans to close six to eight loans a year and has projected a cost of $7,248 to operate the program. The program will require about $40,000 in capital. However, the net savings from preventing each foreclosure is estimated at approximately $25,000, and the value to the family is inestimable.

NHS Boise has learned that working with borrowers who are more than 60 days past due on their loans is extremely difficult. Getting the lender to be patient with these loans requires providing a clear explanation of the program and assurance that the process moves along quickly. That is why the NHS staff have been given the authority to approve the loans directly rather than taking the time to get the loan committee to approve them. It is necessary to make fast decisions regarding loan approvals in foreclosure cases.

The program must necessarily be limited in scope, as the available funds can be depleted quickly in a poorly performing economy. The limit on loan size not only helps to keep the loan fund intact, but also forces the borrowers to make managing their finances a top priority. The loan limit also makes it possible to help more people.

Neighborhood Housing Services of Cleveland

One of the first Neighborhood Housing Services, NHS Cleveland has been in operation for more than 25 years and provides its NeighborWorks® Full-Cycle Lending services to the entire city. Its foreclosure-prevention program has been in existence five years and has been integrated into the organization's postpurchase counseling program. NHS of Cleveland found that recruiting participants for its postpurchase counseling program was difficult, but that adding the incentive of offering foreclosure-prevention loans only to those homebuyers who participated in postpurchase counseling made the program more attractive.

The postpurchase counseling program provides information on managing finances, making mortgage payments on time, homeowner insurance, preventative maintenance and foreclosure prevention. The foreclosure-prevention material includes steps homeowners should take if they are hit with financial hardship, and potential workout options such as loan modifications and preforeclosure sales. The counseling programs are free.

Foreclosure-prevention loans are available for city residents whose income does not exceed 115 percent of the area median income and who are members of the NHS Homebuyers Club. The maximum loan is $2,500 and is provided at market rate for three to 60 months. The loan is secured as a subordinate mortgage. The borrower is charged $300 for document preparation and administrative services, and is required to attend the postpurchase education classes described above.

The program is not advertised. While NHS of Cleveland receives referrals from Homebuyers Club participants, it believes that a more extensive marketing effort would result in more applications than the program could support. The concept behind this policy is that foreclosure-prevention loans often are not needed if homeowners have sufficient postpurchase counseling and education. As evidence of the validity of this concept, only two foreclosure-prevention loans have had to be made.

Colorado Housing Counseling Coalition

The Colorado Housing Counseling Coalition is a coalition of housing counseling professionals who promote affordable housing for low- and moderate-income families through the sharing of knowledge, resources and counseling techniques among its members. Founded in 1980, CHCC provides prepurchase counseling, consumer education, debt management, reverse equity mortgage counseling and foreclosure-prevention counseling. Member organizations are located throughout Colorado and include a number of housing authorities, consumer credit counseling agencies and other nonprofit organizations.

CHCC also brings housing counselors and lenders together to identify and discuss emerging issues in housing counseling. The coalition then develops and provides training on these issues for counselors and lenders. “Having the counselors and lenders go through the training together helps them to understand the loss-mitigation process from each other’s perspective and helps them work together better,” says CHCC President Leslie Swanberg-Elliston.

The Denver area saw a 26 percent increase in the rate of foreclosures between 2003 and 2004. These foreclosures are concentrated in high-proportion minority areas, where subprime lending has also been concentrated. Since 1998, more than half of Denver foreclosures have occurred in just one-fifth of its neighborhoods. Nearly all of these neighborhoods has a larger percentage of minority residents than the city as a whole.

CHCC members respond to households at risk of foreclosure by applying whatever resources their particular organization has to offer, or by referring households to other members if necessary. For example, the Colorado Housing Assistance Corporation (CHAC) provides second mortgages of up to $4,700 to at-risk homeowners in the city and county of Denver who have lived in their homes at least three years and have dealt with whatever problem got them into arrears on their mortgage. It requires that the homeowners go through a counseling program;

although CHAC has a counseling capacity, it sends clients who need a second mortgage to another member of the coalition for counseling.

Another coalition member, Brothers Redevelopment Incorporated, provides a wide variety of housing services, with a strong emphasis on serving senior citizens and the disabled. For more than 30 years, BRI has provided free home-maintenance and renovation services, utilizing a significant force of volunteer labor. Its last annual “Paint-a-thon” had more than 1,000 volunteers paint 114 homes in eight Colorado cities. BRI also provides reverse mortgages for seniors in need of money. Each year, BRI provides default mortgage counseling to about 200 people, reverse mortgage counseling to more than 350 people, and first-time homebuyer counseling to about 240 people.

Neighborhood Housing Services of Hamilton, Ohio

Hamilton, Ohio is another American city that has seen significant job losses in recent years, with many local employers going out of business or relocating. NHS of Hamilton, a chartered member of the NeighborWorks® network, has served its community for eight years and has provided $30 million to housing development and lending. Initially focusing on home-maintenance lending and training, NHS of Hamilton has expanded its services to become a NW Full-Cycle Lender® that provides first mortgages.

NHS of Hamilton decided to supplement its pre- and postpurchase counseling and its training on preventative maintenance with a program, the Rescue Program, for early-intervention assistance for homeowners experiencing financial difficulties. The Rescue Program is available to Hamilton homeowners who have fallen behind in their mortgage payments due to illness or job loss, or who are unable to afford emergency home repairs. The primary qualifying factor for a Rescue Program loan is to be in a financial crisis; there are no income limitations. The applicant receives a credit and income review if NHS staff believe the homeowner can repair his or her financial situation and return to making mortgage payments and maintaining the property. Staff will not make the loan, however, if the applicant has high debt levels and excessive delinquencies and will lose the home regardless of a loan.

Homeowners behind on their mortgage can receive up to four months of payments to bring the loan current through a second mortgage on the property. NHS will also provide funds to fix maintenance emergencies, such as a leaky roof or broken furnace. The homeowner has the option of paying the loan back in installments or deferring loan payments, paying back the loan in full when the house is sold or the owner passes away.

The Minnesota Home Ownership Center

The Family Housing Fund of Minneapolis/Saint Paul established its Mortgage Foreclosure and Prevention Program (MFPP) in 1991, and turned over administration of the program to the Home Ownership Center in 1999. HOC is a nonprofit, intermediary organization dedicated to helping Minnesotans with low and moderate incomes to purchase and maintain homes. It works with a network of community-based organizations to develop high-quality homeownership education, loan counseling and support for potential and existing homeowners.

HOC delivers its foreclosure-prevention services through a partnership of three community organizations: Northside Residents Development Council, Twin Cities Habitat for Humanity, and Saint Paul's Department of Planning and Economic Development. In-depth counseling on financial and personal issues, intervention and advocacy with mortgage servicers and lenders, referrals to community services and assistance in accessing funds are provided to homeowners at risk of losing their homes.

MFPP can provide no-interest loans as emergency financial assistance to help homeowners become current on their mortgages. HOC manages the fund, but the three MFPP partners can approve loans based on a set of criteria designed to sustain homeownership in the long term. These criteria include that: (1) the financial problem is a result of circumstances beyond the borrower's control, such as job loss or medical emergency; (2) the financial situation is solvable and the borrower is willing to work with program staff; and (3) the borrower must be at least 60 days behind in mortgage payments (Quercia et al. 2004).

MFPP has served more than 8,000 households since 1991, with about half receiving information and referrals only and half receiving intensive case management, counseling and/or financial assistance. A study of this program has estimated that the program has prevented 1,756 foreclosures as of June 30, 2003 (Quercia et al. 2004). This study has also identified a number of trends in the program:

- In recent years, the proportion of households receiving information and referrals only has increased relative to the proportion receiving more intensive assistance;
- The percentage of unemployed borrowers increased to 13.5 percent in the first half of 2003 from 9.1 percent during 2002;
- The proportion of nonwhite borrowers increased to 68.5 percent in the first half of 2003, from about 54 percent in 2001 through 2002;
- The average number of years a property was owned before the owner entered the program increased from 5.2 in 2001 to 7.1 in the first half of 2003.

The program is becoming increasingly successful in preventing foreclosures, with the percentage of clients going to foreclosure decreasing from 4.7 percent in 2001 to 2.4 percent in the first half of 2003, a level much lower than that for the life of the program (1991-2003), which is 7.6 percent (Quercia et al. 2004). The study also found that the number going through a loan restructuring or modification increased from 4.2 percent in 2001 to 8.0 percent in 2003. Furthermore, the length of time to resolution has decreased from an average of 281 days to 205 days. Overall, the study of the MFPP found that community-based foreclosure-prevention programs are cost effective.

Home Ownership Matters LLC of Indianapolis

Home Ownership Matters (HOM) is the creation of Mildred Wilkins, a real estate professional and former Fannie Mae foreclosure specialist who sold foreclosed properties. Seeing the rise of foreclosures in Indiana, she decided to take action. Many new homebuyers were caught unaware by the details in their no-down-payment mortgage agreements. For example, a practice known as “2-1 buy down” means that homeowners can obtain an initial interest rate two percent below the current market rate. This “teaser rate” increases by one percent at the end of the first year and by another one percent at the end of the second year. In addition, property taxes are not assessed for 12 to 18 months after owners have moved in, which results in a dramatically increased tax bill when it is assessed. These two factors mean that owners’ house payment during the 2nd and 3rd years may be as much as 35 to 40 percent higher than the day they closed. These practices, along with unprecedented job loss and a downturn in the Indiana economy, have contributed to three in ten new homes in some subdivisions ending up in a sheriff’s sale.

HOM was established in 2002 to help consumers become more knowledgeable about homeownership. HOM provides training programs to reach both consumers and real estate professionals who may have contact with borrowers who are at risk of defaulting on their mortgages. Many real estate professionals have not received in-depth training in loss-mitigation practices, such as restructuring the mortgage after payments have become delinquent. Consumers are also generally unaware of loss-mitigation options and do not know what alternatives to foreclosure they have.

HOM training sessions for real estate professionals, Practical Application of Loss Mitigation (PALM), are targeted to housing counselors, attorneys, community development corporation staff and consumer credit agency staff. In addition, short-sale training for real estate agents is designed to help them become familiar with the process required by lenders to sell the house for less than the mortgage, as a way for a consumer who is in default to avoid foreclosure.

HOM has also provided free sessions on homeownership education that target senior citizens, at senior centers, libraries and homeownership fairs. Through a recent partnership with National City Bank of Indiana, HOM will expand its counseling and education efforts for seniors and for new and prospective homebuyers.

“This strategic partnership allows me to achieve the goals and founding mission of HOM, which is to educate, empower and encourage consumers to sustain homeownership, particularly at a time when Indiana is experiencing such high foreclosure rates,” says HOM President Mildred Wilkins.

Nuestra Comunidad Development Corporation

Nuestra Comunidad was founded in 1981 to serve the Dudley neighborhood of Roxbury, Massachusetts. The organization builds housing and commercial properties, provides small business loans, conducts homeownership education classes and provides job and anti-drug abuse services to the youth of Dudley.

As in many other low-income communities, predatory-lending practices were leading to a high number of foreclosures. Recognizing the need to assure that its homeownership efforts were sustainable, Nuestra Comunidad started a program to help homeowners in financial trouble to keep their homes from going into foreclosure. When a person threatened by foreclosure approaches the organization, a foreclosure counselor acts to:

- Explore the reasons for the financial difficulties;
- Structure a payment plan that fits the owner's circumstances;
- Contact the lender, explaining the circumstances and emphasizing that the owner is working with Nuestra Comunidad to remedy the situation;
- Work with the lender to modify or refinance the loan, perhaps extending the term or reducing the rate.

Nuestra Comunidad has worked out 27 foreclosure cases, helping to keep many families in their homes. It has also approved ten home-improvement second mortgages, provided credit counseling to more than 100 people, and provided budgeting and financial-literacy counseling to 140 households.

Nuestra Comunidad has learned that many homeowners do not know they can negotiate with lenders without resorting to foreclosure. Because homeowners in danger of foreclosure may not seek out help, it is necessary to reach out to homeowners and make them aware of counseling services that are available. Nuestra Comunidad also focuses its efforts on working with lenders, rather than servicers or attorneys, because the lender has a greater incentive to keep the property from foreclosure.

NeighborWorks® of Western Vermont

NeighborWorks® of Western Vermont was founded in 1985 to address the housing needs of four neighborhoods in the small town of Rutland, but has since expanded to serve three Vermont counties. It has loaned approximately $5 million to nearly 400 homeowners to make needed housing repairs and has provided access to grants and loans for housing rehabilitation, weatherization, handicap access and lead paint abatement from other agencies. It also provides grants and loans for emergency shelter for families facing homelessness.

NeighborWorks® of Western Vermont promotes homeownership, holding monthly Homebuyer Education classes that have helped more than 350 households understand the purchasing process. It also has loaned $3.75 million for affordable homeownership to 331 local families, leveraging an additional $24 million from lenders.

The prolonged recession in New England has impacted homeowners in Vermont, with foreclosures often coming as a result of family difficulties, unemployment, and income or life skills problems. The connection that NeighborWorks® of Western Vermont has made between the economy and homeownership has helped it acquire the support it needs to make the program a success. This NHS discovered that foreclosure intervention could not be accomplished by one agency, but required multiple organizations that could work together and be willing to contribute something to the effort.

The organization focuses its foreclosure-prevention efforts on educating homebuyers in pre-purchase counseling sessions about the importance of staying current on their mortgage and what to do if financial calamity strikes. Part of the eight-hour prepurchase educating informs participants about how people can get behind on their mortgages and who to contact if they have trouble. In addition, the participants sign an agreement that allows the loan servicer to contact NeighborWorks® of Western Vermont if the borrower does get behind in payments. The agreement is part of a larger program that the NHS has formed with the Vermont Housing Finance Agency which helps to assure the long-term viability of homeownership.

“We want to build a relationship with the homeowner that lasts beyond the purchase,” says Housing Counselor Deborah Wing. “We want them to know we are a long-term resource for them.”

NeighborWorks® of Western Vermont can also provide some funds or financial counseling in the case of an emergency. Often emergencies involve rural, elderly clients who contact the NHS because they need emergency repairs. The organization can access the Emergency Shelter Fund to provide grants to cover short-term housing expenses, but these funds are very limited. Most of the people in these situations are referrals, not NHS clients. Deborah Wing believes that the prepurchase preparation that is provided keeps their own clients from having to access these services.

Neighborhood of Affordable Housing, East Boston

Neighborhood of Affordable Housing in East Boston is a community development corporation that began operations in 1987 and serves culturally diverse neighborhoods throughout the Boston area. NOAH provides first and second mortgages and refinancing loans, and supplements lending with home repair assistance, financial education and homeownership counseling. It also improves green space and schoolyards, provides youth activist and employment training, and manages affordable rental properties.

This organization has taken a different approach to the foreclosures that plague their community. NOAH has developed an efficient method for getting troubled properties back on the market quickly, avoiding the problem of foreclosed homes becoming abandoned properties that can bring down neighborhood housing values.

In 2001, NOAH began to focus on homeownership promotion as a strategy for stabilizing the East Boston neighborhood, an area near Logan International Airport. The housing market there had been hot in the 1980s, but went into a downturn that caused many homes to go into foreclosure, threatening NOAH’s stabilization efforts. NOAH first tried to buy and rehabilitate the worst properties, but found such an approach required substantial subsidies. The organization then used purchase-rehabilitation financing to help families buy homes and do their own rehabilitation, but this process was too difficult for first-time homebuyers. In order to reach sufficient scale, NOAH needed to focus on properties that needed little repair and could be bought at discounted prices.

NOAH reached an agreement with Fannie Mae to acquire its foreclosed properties at a 15 percent discount off regular market prices. It obtained access to properties early in the foreclosure process in order to perform inspection, spec preparation and cost estimation. If the property was viable, NOAH took title immediately after Fannie Mae took it into its inventory. NOAH used pre-arranged financing with Bank of Boston that provided a loan of up to 95 percent of value and allowed a one-time assumption of the mortgage. Thus, the buyer could make a five percent down payment to NOAH and assume the mortgage. Most buyers were in the 65 to 80 percent range of median area income.

An Examination of Community Foreclosure-Prevention Programs

A recent study of postpurchase programs by Baker (2004) includes an examination of successful foreclosure-prevention practices. This insightful analysis describes the key components of a foreclosure-prevention program and the various levels of effort that can be undertaken, based upon the resources available.

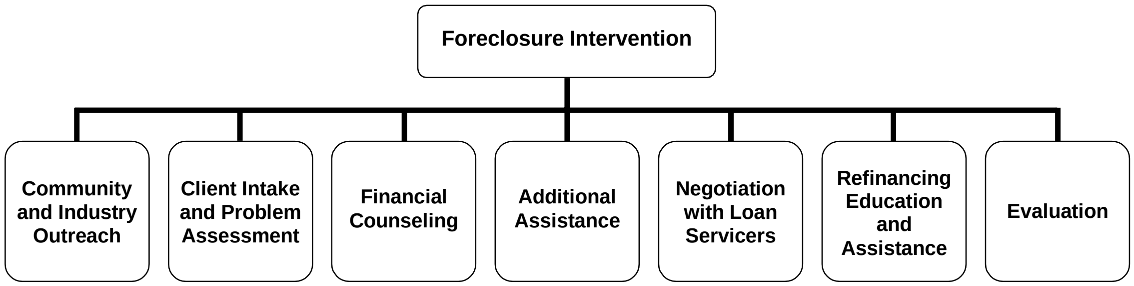
Baker also points out some of the challenges to creating a successful program:

- The need to coordinate a wide range of services, some of which may have to come from a number of partner organizations;
- An ability to work with a broad range of clients;
- The need for expertise in areas such as loss-mitigation techniques, alternative mortgage financing and legal issues related to predatory lending and bankruptcy.

The key to keeping a mortgage from going into foreclosure is to address the problem early. This, in turn, makes the marketing of services and outreach to potential clients an important component of a successful program. However, a community organization can quickly be overwhelmed by clients. Any organization that decides to take on foreclosure prevention needs to determine the level of effort that its resources will allow.

Baker's analysis describes seven levels of service a foreclosure-prevention program can provide, from the most basic, Level 1, to the most sophisticated, Level 7. Level 1 service is defined as providing counseling services to one's own clients, with limited phone services and referrals available to other clients. Level 2 services include making available refinancing and home-equity loans for one's own clients. Levels 3-7 involve providing services to the general public. Each level involves the provision of more complex services, such as debt management and predatory-lending counseling. The more advanced levels require having the capacity for electronic collection and transfer of debt payments.

Figure 3: Key Components of Foreclosure-Intervention Programs



Source: Baker, Christi (2004).

Baker lists ***seven key components*** for a foreclosure-prevention program. The ***first component*** is community and industry outreach, in order to get to clients as early as possible. The amount of outreach depends upon the level of service the program will provide, particularly whether it will serve clients from the general public. Successful organizations often also set up early delinquency notification agreements with servicers.

The ***second component*** is client intake and problem assessment. Baker states that because clients are often reluctant to make contact with a service provider, the agency must make its services easily available and reassure the homeowner that they are there to help. It is crucial that in the initial contact with the homeowner, the counselor is friendly and supportive. The counselor should also determine the following: (1) the length of delinquency; (2) the client's desire to stay in the home; (3) the circumstances surrounding the delinquency; (4) the ability of the homeowner to become current with the loan; (5) the owner's willingness to work with a counselor; (6) whether predatory lending may be involved.

The ***third component*** is financial counseling that is aimed at helping the homeowner achieve a long-term sustainable solution to the problem. Baker finds that good budget counseling alone in many cases can help borrowers recover from delinquency. Clients may need to be referred to debt-management counseling if credit card debt is significant.

The ***fourth component*** of a foreclosure-prevention program includes much more resource-intensive and sophisticated forms of assistance, such as legal assistance, particularly if predatory lending is involved; financial assistance, such as bridge loans or grants; and other types of counseling services which may include job or family counseling, depending on the circumstances of the delinquency.

The ***fifth component*** involves negotiations with the loan servicers. Baker states that this can be a staff-intensive activity but nearly always brings quicker results for the borrower. Working with servicers is important because they will see that the borrower is interested in curing the delinquency and has assistance from an agency to ensure success. It is also extremely important to have consistent contacts with loan servicers who have the authority to approve loss mitigation options, in order to assure that the process is handled expediently.

Refinancing assistance and education is the ***sixth component.*** The borrower may need access to reduced interest rates, better loan terms or funds to cure the delinquency. Having a lending capacity, or access to it, strengthens the foreclosure-prevention program. An expedited process for providing financing also helps to assure that the delinquent loan is cured successfully, particularly in cases where predatory lending is involved. In addition, because homeowners are flooded with offers to refinance or take out home-equity loans, refinancing education can help guide them to safe financing options.

The ***seventh component*** involves evaluating the effectiveness of the foreclosure-prevention program. Baker emphasizes the importance of agencies tracking their clients' progress to determine if they are successful on both a short- and long-term basis, perhaps for as long as three years after assistance is provided. Although evaluation uses valuable resources, this component assures staff that their efforts are effective and provides evidence for the factors that contribute to program success.

The nature of the staffing of a foreclosure-prevention program is a vital concern. Staffing needs depend upon the level of services to be provided. Baker estimates that, on average, foreclosure-intervention counselors can work with four to six clients per day. In general, staff require the following: lending experience, including knowledge of home-rehabilitation and refinance lending; knowledge of loss-mitigation procedures; and personal counseling skills. Foreclosure-prevention counselors need to be able to negotiate with lending institutions and, potentially, even bring pressure on lenders. Their work can be facilitated by understanding servicer policies and procedures. When interacting with their clients, counselors also must be able to be tough and supportive at the same time.

Summary

While community-based foreclosure-prevention programs vary from place to place according to local circumstances and resources, a number of components are necessary at a minimum. First, outreach to potential clients is important because of the short time to foreclosure for many loans and the reduction in costs that comes from addressing a default early. The amount of outreach must be balanced with available resources, however, as foreclosure prevention is a staff-intensive process, and an organization can quickly be overwhelmed with requests for assistance. Second, negotiation with lenders and homeowners is crucial to success, although it can be challenging to agency staff. Foreclosure-prevention staff must understand the loan and loss-mitigation processes, be familiar with the lending institutions' policies and procedures, and be skilled at personal counseling. Moreover, the most successful programs provide a variety of services that generally interact, which may include budget counseling, job and family counseling, loan products or access to loans, and financial education.

Section IV: Case Studies: Foreclosures in Chicago and New York City

Foreclosures have affected community development activities in a number of cities across the country and, as seen above, local organizations have implemented a variety of strategies and programs to combat the ill effects of increased foreclosures on the neighborhoods they serve. The NHSs of Chicago and New York City stand out in their response to the problem, however, implementing multifaceted and comprehensive programs. While not all communities have the resources of these two large cities, an in-depth examination of their foreclosure-prevention programs will help demonstrate the possibilities for an effective community-based response to rising foreclosure rates.

Preserving Homeownership in NHS of Chicago's Targeted Neighborhoods

Established in 1975, Neighborhood Housing Services of Chicago currently targets its revitalization efforts toward nine neighborhoods with a combined population of a little more than half a million. NHS of Chicago provides homeownership education and counseling; mortgage, refinance and home-improvement loans; construction oversight; loan counseling; and foreclosure intervention. Its Redevelopment Corporation supports neighborhood revitalization efforts by acquiring and renovating high-quality affordable housing. In 2001, it helped 2,500 homebuyers and supported the renovation of more than 300 housing units. NHS of Chicago focuses its programs and services on nine key neighborhoods in the city: Auburn-Gresham/Englewood, Back of the Yards, Chicago Lawn/Gage Park, Garfield Boulevard, North Lawndale, Roseland, South Chicago, West Englewood and West Humboldt.

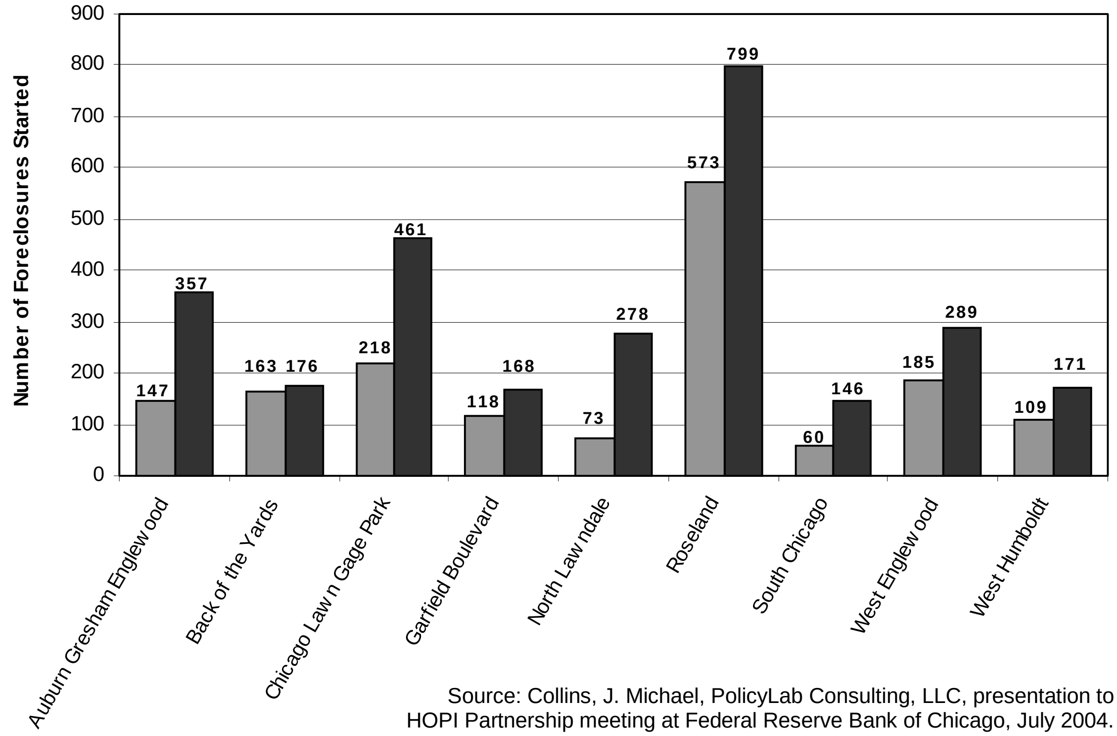
Foreclosures on the Rise

While these neighborhoods account for just 18 percent of Chicago's population and five percent of all mortgage originations in 2001, they experienced 41 percent of the city's foreclosures (Apgar et al. 2004). These nine neighborhoods had a 2001 foreclosure rate of 7.7 percent, compared to 4.7 percent for the city and 1.15 percent for the nation overall (Collins 2003). One of the neighborhoods had a foreclosure rate of 30 percent.

The rate of foreclosures and the speed with which they occur have been increasing substantially (Collins 2003). Between 1993 and 2001, the number of foreclosures in the nine target neighborhoods increased 73 percent, and in four of them the number of foreclosures more than doubled. Furthermore, more than half of the loans foreclosed on in 2001 were less than three years old, while in 1993 less than 15 percent of foreclosed loans were that age. (Figure 4, following page.)

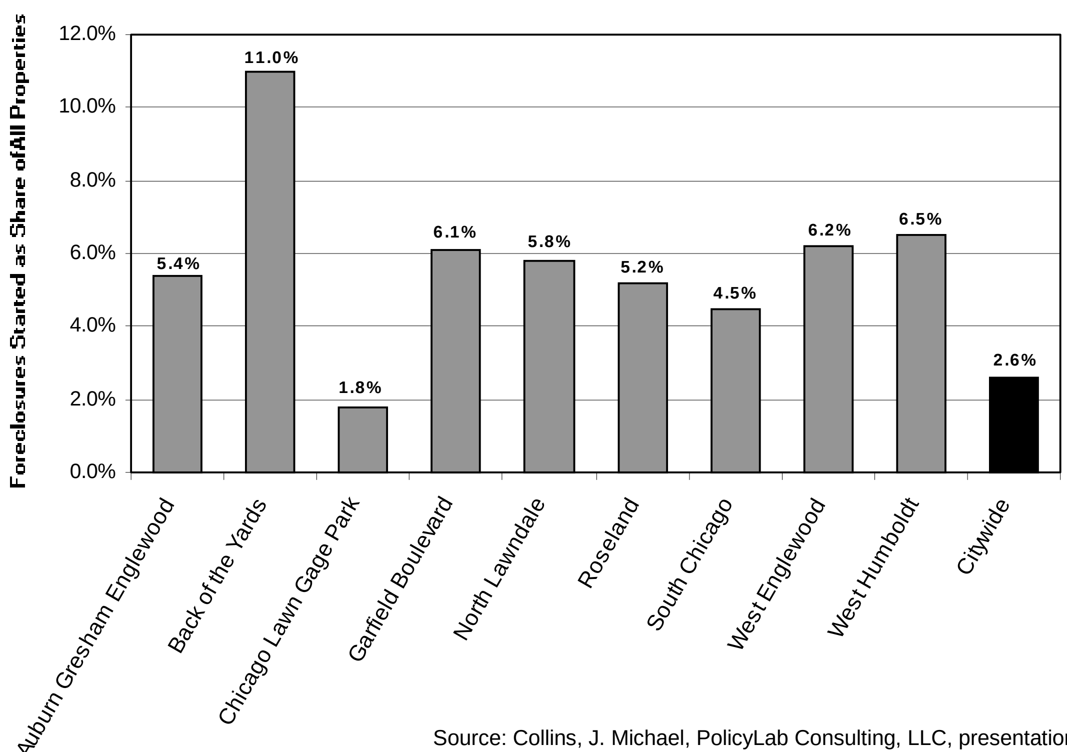
As a share of all properties, foreclosures are becoming dangerously high in several of these neighborhoods. Back of the Yards, in particular, with 11 percent of its properties having experienced foreclosures, is seeing a foreclosure rate that will likely create significant blight from abandoned properties. More than half of these neighborhoods are seeing foreclosures on property that are more than double the citywide rate. (Figure 5, following page.)

Figure 4: Foreclosures Started, NHS of Chicago Targeted Areas, 1993 and 2001



Source: Collins, J. Michael, PolicyLab Consulting, LLC, presentation to HOPI Partnership meeting at Federal Reserve Bank of Chicago, July 2004.

Figure 5: Foreclosure Starts as a Share of All Properties, NHS of Chicago, 2001



Source: Collins, J. Michael, PolicyLab Consulting, LLC, presentation to HOPI Partnership meeting at Federal Reserve Bank of Chicago, July 2004.

Subprime Lending and Foreclosures

The increase in foreclosures is due, in large measure, to the increase in subprime lending. The number of Chicago subprime foreclosures increased by 223 percent from 1997 to 2003, while prime foreclosures declined by 20 percent (NTIC 2004). The number of subprime foreclosures was more than twice the number of prime foreclosures in 2003, with 2,894 subprime foreclosures compared to 1,268 prime foreclosures (NTIC 2004).

Subprime lending has been focused on neighborhoods that, like the neighborhoods served by NHS of Chicago, are predominantly African-American. The nine neighborhoods NHS of Chicago targets are 94 percent African-American. ACORN analyzed subprime lending by race for the largest metro areas in 2001 and estimated the disparity in the subprime market between whites and African-Americans (ACORN 2002). The Chicago metro area ranked in the top ten of 67 metro areas in racial disparity, for both refinance and home-purchase lending. The analysis showed that African-Americans in the Chicago metro area were 7.3 times as likely to use a subprime lender for refinancing as were whites and 7.1 times as likely to use a subprime lender for home purchase. Given that 62 percent of African-Americans in the Chicago metro area live in the City of Chicago, it is likely that most of these loans were made within the city boundaries. The ACORN findings echo the findings of an earlier report that found subprime loans were eight times more likely in predominantly black neighborhoods of the Chicago metro area than in predominantly white neighborhoods (HUD 2000b).

The NHS of Chicago Response to Increased Foreclosures

Facing up to these grim figures, NHS of Chicago and the city of Chicago launched a campaign to combat foreclosure. The mayor and the president of the Federal Reserve Bank of Chicago convened a group of civic leaders to create the Home Ownership Preservation Initiative (HOPI). HOPI's goals are as follows:

- Help 1,500 homeowners in danger of foreclosure to keep their homes, using loss-loan workouts, refinancing and emergency loans to bring homeowners current;
- Reclaim 300 foreclosed properties as neighborhood assets and turn them into homeownership opportunities; and
- Document lessons learned about what are the best practices in homeownership and property preservation.

The program includes creating partnerships with local lending institutions, making financial assistance available and providing an array of counseling services. The partnerships and loan and counseling services are described separately, but are generally used in combination in order to keep homeowners from foreclosure.

HOPI Partnerships

One of HOPI's primary strategies is to work with local subprime lenders on the issues that contribute to default and foreclosure. Much of the discussion between the partners is based on a recent report released by NHS of Chicago that describes subprime lending and foreclosure: Preserving Home Ownership: Community-Development Implications of the New Mortgage Market. The partnership has created working groups focusing on these areas:

- *Loss mitigation:* Outreach to troubled borrowers to get them into a foreclosure-prevention program as quickly as possible;
- *REOs:* Taking foreclosed properties (called "real estate owned" or REO) and getting the lender to sell them at discount so that they can be resold (NHS of Chicago has purchased and rehabilitated more than 100 units in two target neighborhoods as part of a national pilot program with HUD); and
- *Prevention in origination:* Developing the best practices for loan originations to ensure that the loan is structured for the borrower to succeed.

NHS of Chicago has established excellent working relationships with local lenders and can negotiate for temporarily reduced interest rates on loans and other methods for helping homeowners become current on their payments. The organization has developed these relationships based on mutual trust and respect, and works tirelessly on behalf of the homeowner. "You must have open and honest communication with the lenders to make the process successful. They can turn our requests down but will always come back and try on the next deal. We are good at taking rejection," says Irma Morales, Director of New Lending Partnerships and Alliances at NHS of Chicago.

Financial Assistance

NHS of Chicago also helped to bring into existence a loan pool to help families in danger of foreclosure, the Neighborhood Ownership Recovery Mortgage Assistance Loan (NORMAL). NORMAL was created in 1999 by a task force of local lenders, city officials, housing advocates and NHS staff. The task force developed policies and procedures for the loan product, set underwriting guidelines and put together a loan committee of representatives from the lending institutions that invested in the fund. NHS of Chicago created a loan-participation pool and offered shares to lenders at $100,000 per share. Eighteen institutions participated in 22 shares, creating a $2.2 million fund.

Once a client in need of assistance has been identified, NHS staff work with the homeowner to help him or her qualify for conventional refinancing. Often with the help of the Legal Assistance Foundation, NHS of Chicago then negotiates with the lender or servicer to reduce the mortgage amount and prevent the loss of ownership. The NORMAL loan is used to refinance the first mortgage. The refinanced mortgage must be negotiated to a reduced payoff, and cannot be used to repay other revolving or installment debt. The loans are for refinancing predatory loans, rehabilitating a property or carrying out foreclosure intervention. The borrowers must be owner-occupants who in order to qualify must have adequate disposable income to repay the loan and good credit histories. Borrowers are also expected to contribute their own funds to the transaction.

The loans are fully amortizing, at the rate of the Fannie Mae 60-day rate plus 50 basis points. The loan amount cannot exceed Fannie Mae or Freddie Mac maximums and the loan-to-value and combined loan-to-value limits must meet NeighborWorks® standards. Closing costs include a limited loan origination fee, which can be financed. NHS of Chicago then services the loan.

Fifteen NORMAL loans have been approved at an average amount of nearly $70,000. Ten of the loans prevented impending foreclosures and resulted in mortgage reductions of $5,000 to $45,000. Participation in the program has helped NHS of Chicago to expand its partnerships with local lenders and create new relationships.

In addition to NORMAL, the HOPI initiative leverages funds from the city of Chicago. The city has forgivable loans for lower-income households that need maintenance and repairs done on their properties. Often homeowners acquire expensive loans to cover home repair, and unscrupulous contractors will take the money and leave the repairs undone. NHS of Chicago administers the forgivable loan program for the city because city officials have recognized that NHS of Chicago can augment these funds with money from private investors.

Counseling Programs

NHS of Chicago receives over 100 calls a month for homeownership preservation assistance. Based on the homeowner's situation, the trained staff then directs the caller toward the appropriate solution, which may include a negotiated payment plan, legal assistance, conventional refinancing or some type of loan. NHS of Chicago receives referrals from its lender partners, through the city's anti-predatory-lending and consumer-education campaign, from its role as a HUD-certified counselor and by working with neighborhood organizations.

Results

HOPI partners have prevented 690 foreclosures in the first 18 months of the initiative. The city has established a "311 Home Ownership Preservation Campaign" that allows homeowners at risk of foreclosure to call a non-emergency 311 line to talk to a credit counselor. A series of workshops have provided incentives to customers in high-risk neighborhoods to attend informational sessions prior to the possibility of experiencing any financial difficulty.

Foreclosure rates in low-income and minority neighborhoods in Chicago declined in 2003 for the first time in a decade. Foreclosures in low-income neighborhoods — those with incomes up to 50 percent of area median income — declined by 17 percent, from 2,958 in 2002 to 2,460 in 2003, while foreclosures in moderate-income neighborhoods declined 13 percent, from 3,827 to 3,339, during that period; at the same time foreclosures dropped just 4.5 percent in higher income neighborhoods (NTIC 2004). In predominantly minority neighborhoods, foreclosures declined 16 percent from 2002 to 2003 while declining only 3.8 percent in other neighborhoods (NTIC 2004).

In their preservation program, NHS of Chicago has also reclaimed 111 formerly vacant properties through development activities and purchase-rehab lending. A number of financial institutions have donated or sold at discount some low-value properties to NHS for preservation. NHS of Chicago and the city of Chicago have also partnered with HUD to reclaim foreclosed FHA properties. In addition, the City Council passed the Troubled Buildings Initiative II, which provides financial resources to rehabilitate abandoned properties.

NHS of Chicago has also worked hard to promote a better understanding of the impact of foreclosures on community development, including publishing the report mentioned above, *Preserving Home Ownership: Community-Development Implications of the New Mortgage Market.* In addition, Neighborhood Reinvestment Corporation is establishing a Center for Foreclosure Solutions to explore how community organizations across the country can learn from the experiences of Chicago and other cities in preventing foreclosure.

Lessons Learned

NHS of Chicago staff found that the NORMAL program needs to be tied to a full range of counseling and information services to be fully effective, which they accomplished with the establishment of HOPI. Financing needs to be flexible, and payments need to be kept low enough to allow homeowners a chance to succeed. The staff also cite the importance of seeking additional funding that may be available, such as closing-cost assistance or rehabilitation grants.

NHS staff warn that foreclosure-prevention programs are time- and labor-intensive and that they can put a strain on an agency’s resources. But they also feel these programs are essential to assuring that target neighborhoods do not see a significant increase in failed homeownership cases and abandoned properties. NHS of Chicago Executive Director Bruce Gottschall is convinced that foreclosures have a “contagion effect,” whereby a number of foreclosures tends to cause more foreclosures: “one foreclosure often prompts another and another and in no time a decade of neighborhood revitalization work can be undone” (Apgar et al 2004).

Foreclosures and Neighborhood Revitalization in New York City

Neighborhood Housing Services of New York City was established in 1982 and has assisted nearly 100,000 residents, rehabilitated 6,000 housing units and stimulated more than $950 million in public and private investment. Using its own architects and rehab specialists, NHS of NYC has made 23,000 home inspections and conducted more than 1,500 home repair workshops. Its HomeBuyers Clubs and counseling programs have prepared residents for homeownership. It has also packaged first mortgage loans valued at more than $175 million.

NHS of NYC focuses its efforts on traditionally underserved, minority neighborhoods in all five boroughs, including Harlem and the Lower East Side in Manhattan; Bedford-Stuyvesant, East New York, East Flatbush, Red Hook and Erasmus in Brooklyn; West Brighton in Staten Island; the South Bronx and the North Bronx; and Jamaica, South Ozone Park, Richmond Hill, Woodside, Long Island City, Jackson Heights, the Coronas, and Elmhurst in Queens.

The Rise of Foreclosures in New York Neighborhoods

The neighborhoods were examined using data from the New York City Housing and Neighborhood Information System (NYCHANIS), administered by the Furman Center for Real Estate and Urban Policy at New York University. The neighborhood definitions and names are for “subborough areas” created by the Census Bureau for the administration of the New York Housing and Vacancy Survey. The subborough areas roughly approximate the neighborhoods served by NHS of NYC. Some names used for the subborough areas were abbreviated in this report. The database provided by the Furman Center provides a wide variety of data using various geographic definitions; more information is at www.law.nyu.edu/realestatecenter/nychanis/index.html.

Foreclosures in New York City increased by more than 25 percent between 2000 and 2003, but the hardest hit neighborhoods were all among the NHS of NYC target neighborhoods. Seven of these neighborhoods had foreclosure rates in 2003 that were more than twice the city rate: Jamaica, University Heights in the North Bronx, Queens Village, East New York, East Flatbush, Williamsbridge in the North Bronx, and South Ozone Park. Three more target neighborhoods had foreclosure rates higher than the city rate and are of particular concern to NHS staff: South Crown Heights, Bedford-Stuyvesant and Bushwick. Although containing less than 20 percent of the city’s population, these ten neighborhoods accounted for 60 percent of the city’s foreclosures in 2003.

Jamaica is the largest of the neighborhoods, with more than 42,000 homeowners in 2002. In 2003, it also had the largest number of foreclosures, 664, or more than 1.5 percent of the owned units, a growth of more than 20 percent since 2000. The other neighborhoods have seen lower rates than Jamaica’s, but a number of them experienced greater growth in foreclosures. For example, East Flatbush has seen a 50 percent increase in foreclosures since 2000, rising from 86 to 131.

Table 3: Foreclosure Rates for Selected NHS of New York City Target Neighborhoods and the Rest of New York City, 2000 to 2003

Neighborhood	*2000*	*2001*	*2002*	*2003*
Jamaica	1.29%	1.41%	1.51%	1.55%
University Heights	0.92%	0.92%	1.54%	1.54%
Queens Village	0.84%	0.93%	0.98%	0.99%
East New York	0.59%	0.76%	0.74%	0.77%
East Flatbush	0.53%	0.76%	0.82%	0.81%
Williamsbridge	0.60%	0.61%	0.83%	0.78%
South Ozone Park	0.47%	0.62%	0.57%	0.63%
South Crown Heights	0.28%	0.54%	0.57%	0.54%
Bedford-Stuyvesant	0.31%	0.27%	0.34%	0.35%
Bushwick	0.20%	0.34%	0.23%	0.30%
Rest of City	0.11%	0.11%	0.13%	0.13%
Citywide	0.22%	0.25%	0.27%	0.28%

Source: Furman Center for Real Estate and Urban Policy, New York University.

In most respects these neighborhoods are not much different from New York City overall (Table 4). However, all but two of the ten neighborhoods have significantly higher proportions of African-American residents, with six having percentages more than double the city-wide percentage.

Table 4: Selected Characteristics of High-Foreclosure Neighborhoods Served by NHS of New York City

Neighborhood	*Percent Black 2000*	*Median Income 2002*	*Change in Poverty Rate 1990 to 2000*	*Median Housing Value 2002*
Jamaica	74.4%	$42,000	3.2%	$161,462
University Heights	37.9%	$20,800	–3.5%	$161,462
Queens Village	56.7%	$54,348	1.8%	$188,372
East New York	50.0%	$30,000	2.5%	$177,608
East Flatbush	79.6%	$36,600	4.9%	$194,831
Williamsbridge	69.2%	$33,000	7.7%	$193,755
South Ozone Park	17.4%	$45,800	4.5%	$193,755
South Crown Heights	81.7%	$32,000	5.8%	$188,372
Bedford-Stuyvesant	77.6%	$24,840	–0.8%	$193,755
Bushwick	27.2%	$24,800	–4.0%	$177,608
Citywide	***27.3%***	***$39,100***	***2.0%***	***$188,756***

Source: Furman Center for Real Estate and Urban Policy, New York University.

These neighborhoods have also seen a significant increase in subprime lending (Table 5). Between 2000 and 2002, subprime lending in the ten neighborhoods increased approximately 60 percent. With 20 percent of New York's population, the ten neighborhoods accounted for more than 40 percent of all subprime lending. Most of the subprime lending in these neighborhoods was for refinances, accounting for three-quarters of all subprime loans. The rise of subprime lending has been linked to increased foreclosures in other parts of the New York metropolitan area (Abt 2002).

Table 5: Subprime Loans in Selected NHS of New York City Neighborhoods: 2000–2002

Neighborhood	*2000*	*2001*	*2002*	*% Change 2000–02*
Jamaica	989	1,131	1,538	55.5%
University Heights	63	73	81	28.6%
Queens Village	799	1,054	1,417	77.4%
East New York	340	394	533	56.8%
East Flatbush	434	566	699	61.1%
Williamsbridge	401	451	663	65.3%
South Ozone Park	367	431	659	79.6%
South Crown Heights	142	161	225	58.5%
Bedford-Stuyvesant	369	400	492	33.3%

Bushwick	226	275	289	27.9%
All 10	4,130	4,936	6,596	59.7%
Citywide	8,425	11,312	15,896	88.7%

Source: Furman Center for Real Estate and Urban Policy, New York University.

NHS of NYC staff is also concerned about outright predatory lending and fraud in the home-improvement business. For example, clients in mortgage default have told staff they were directed to falsify income levels so they could be approved for their mortgage. There have also been cases of investors buying inexpensive properties — some of which had been foreclosed upon — making a few cosmetic improvements, and then selling the homes at vastly inflated prices.

NHS of NYC's Response to Foreclosures

NHS of NYC is a NeighborWorks® Full-Cycle Lender®, providing pre- and postpurchase counseling and education, as well as closing-cost and down-payment assistance. Its foreclosure-prevention program includes early-delinquency intervention, foreclosure-prevention orientation, a predatory-lending awareness orientation, one-on-one counseling and a five-week foreclosure-prevention class.

NHS of NYC staff knows that the sooner a delinquent homeowner contacts them, the more likely they will be able to prevent a foreclosure. In order to alert homeowners of these services, the foreclosure-prevention staff has been holding forums in target neighborhoods, particularly Jamaica, to help get the word out. Through a partnership with New York's utility company Con Ed, contact information is also provided on utility bills, putting the foreclosure-prevention number in front of homeowners every month. NHS of NYC is also seeking to be included as an option on the city's "311" consumer information line.

The foreclosure-prevention orientation is an overview of options related to loss mitigation, emphasizing how delinquent borrowers can prevent the loss of their homes. It covers what to do when making mortgage payments becomes difficult, how to assess finances and develop a budget, alternatives available to delinquent borrowers, and how to avoid predatory lenders and home-equity fraud. The foreclosure-prevention class covers these topics in depth, meeting two hours a week for five weeks. Participants get hands-on training in managing income and debt and developing a household budget. The instructor provides information on bringing a loan current, using loss-mitigation tools such as reducing monthly payments, getting a temporary deferment, modifying the loan terms or refinancing the mortgage.

The success of the prepurchase counseling is evident to staff working in foreclosure prevention. "We never had to do foreclosure-prevention counseling for anyone who had taken our prepurchase homeownership education classes," says Ken Davis, foreclosure-prevention counselor.

NHS of NYC also provides a course on losing one's home with dignity, for those situations where the homeowner is unable to keep up with mortgage payments. Borrowers sometimes fall too far behind in their payments to be able to make the loan current again and, as a last resort, are encouraged to sell the home themselves. Many buyers should not have been placed in their homes in the first place, but have been put there by unscrupulous brokers. Also, some homeowners experience significant income decline because of job loss or divorce, and no agreement with the bank will make the loan tenable.

A reverse-mortgage program has also been established for elderly homeowners who need home repair work done, have trouble paying taxes, or have become victims of predatory lenders. The borrower can often get a reverse mortgage when they cannot obtain any other form of financing because of a lack of creditworthiness. The reverse mortgage allows the owners to stay in the home and make necessary repairs, and the owners' heirs have up to a year to buy or sell the home.

The Importance of Partnerships

NHS of NYC has a successful foreclosure-prevention program because of the partnerships it has established. The organization collaborates with banks, pro bono legal services, the secondary market institutions, employers, corporations, foundations, nonprofit and faith-based organizations, and federal, state, and city officials, in all five boroughs. For example, NHS of NYC partners with Fannie Mae and the Parodneck Foundation to provide relief to senior citizens who have been victimized by predatory lenders. It is also a member of the loss-mitigation team for HUD's hot zones, which provides special loss-mitigation procedures for reinstating FHA loans facing foreclosure due to predatory lending.

However, the organization's most important partnerships are with local banks. Unlike NHS of Chicago, NHS of NYC does not have a loan fund, so it has to rely on the lender to agree to loan modifications that can save a home. The banks trust NHS of NYC, and appreciate that delinquent borrowers who are being assisted by its counseling programs have a greater chance of avoiding foreclosure. NHS of NYC helps borrowers get loan workouts, such as reducing outstanding balances or waiving late charges, legal fees and interest in arrears. Usually the mortgages become refinanced through the existing lender. NHS of NYC also uses its home-improvement program for any necessary repairs and seeks refinancing through other banks.

"Our strength is our banking partners who see us as the means for delivering services they cannot," says NHS of NYC Chief Operating Officer Bernell Grier. "When the issue involves homeownership, and they are looking for nonprofit partners, the banks come to us first. For example, a bank called us to establish a loan fund for people facing foreclosure, as they were anticipating an economic downturn and rising foreclosures. They came to us first because of our reputation and experience."

Lessons Learned

NHS of NYC has found that foreclosure-prevention information should be presented as part of the prepurchase homeownership information session. This information should emphasize the importance of communicating with lenders as soon as trouble arises, to prevent more severe problems.

Staff must be familiar with the lending staff, servicing staff and, most importantly, the rules and procedures for loss mitigation of the local financial institutions. Conversely, it is also important to keep banking staff informed of NHS program guidelines and goals and to get their support for the program. NHS of NYC often serves as the liaison between the bank and the borrower, so good relations with the bank's professional staff is key to success. Good communication and mediation skills are necessary, since negotiating with lenders and servicers is a critical part of the program.

Section V: Conclusions

Creating homeownership opportunities has long been a central strategy for community revitalization. Increasing homeownership rates in distressed areas provides a number of positive benefits to the community, including stabilizing the local housing market and creating stakeholders for further revitalization. It also benefits low-income households, providing them with their primary means for building wealth.

Increases in homeownership rates are not due just to the efforts of community developers, but also have been made possible by new, innovative mortgage products specifically designed for low-income families. Underwriting advances, specifically risk-based pricing, and stratified securitization have allowed lenders to provide mortgages to households that may not have qualified for them prior to these developments. Low-income homebuyers with lower credit ratings and fewer savings for down payments can now find mortgage products that meet their needs. Many of them qualify for subprime loans, paying more for their access to capital in exchange for the increased risk that lenders are taking.

This loan risk can be mitigated by prepurchase counseling programs that help new homeowners understand how to handle their finances and make their monthly payments so as to retain their homes. Prepurchase counseling, properly provided, has been shown to reduce default rates (Hirad and Zorn 2001). Moreover, postpurchase counseling and foreclosure-prevention programs, such as those described in this report, also help to mitigate the risk of subprime lending, reducing the number of mortgages that actually go to foreclosure. These community-based efforts are crucial to ensuring that the increase in lending risk that risk-based pricing has allowed is minimized.

Over the past several years, however, the rate of subprime foreclosures has been on the rise, though it has declined somewhat in the past two years. A substantial amount of evidence suggests that this increase has been concentrated in low-income and minority neighborhoods, with some indication that foreclosure rates in those neighborhoods may also be declining (NTIC 2004). The cause for this recent decline in foreclosure rates has not been determined, but it is likely that some credit belongs to the activities of community organizations that have been active in fighting foreclosures. The NTIC data is from Chicago, which has one of the most sophisticated community-based foreclosure programs in the country.

As subprime lending increases in distressed neighborhoods — neighborhoods that tend to have high proportions of low-income and minority populations — the need for sophisticated foreclosure-prevention programs also increases. It is likely that foreclosure-prevention programs will demonstrate success similar to their prepurchase counterparts. While they are resource-intensive, these programs can protect distressed communities from the possible negative consequences of higher-risk lending.

The models that have been developed to allow riskier lending do not take into account the contagion effect that concentrated foreclosures appear to produce, particularly in areas where the housing market is not strong. In part this is because sufficient research has yet to be done which would allow an estimation of the effect. Despite the lack of empirical evidence, there is some anecdotal evidence that the contagion effect exists (and many practitioners would attest to it) and that the cost of foreclosure can go beyond the impact on an individual home. Therefore, the risk that is allowed for loans in these communities needs to be counterbalanced by programs that reduce the chance of foreclosure.

A number of approaches to preventing foreclosure, or to mitigating its effects, have been described here. The proactive approach of NHS of Chicago, working with the subprime lenders directly and developing best practices for mortgage originations, seems to have the potential for highly significant benefits. In addition, there is a need for an expanded public sector role in developing financial literacy and in improving disclosure and reporting requirements to assure that homebuyers understand their options and can select the best product for themselves, as has been suggested in another analysis (Collins et al. 2004). This analysis also suggests an expanded oversight role for regulators and endorses the concept of origination best practices.

However, it should also be remembered that most loan foreclosures are not consequent to subprime loans; many more prime loans are made than subprime, and foreclosures occur on those loans as well. While subprime loans foreclose at a higher rate and a shorter time from origination, foreclosure-prevention activities must also address those issues that go beyond subprime lending and look at issues such as equity dilution and job security. When foreclosure cannot be prevented, programs for selling homes quickly, like the ones developed by NHS of Chicago and NOAH, can help to eliminate the contagion effect.

The recent increase in foreclosures in low-income and minority neighborhoods threatens the positive work of community development. Sustaining homeownership is becoming as important an activity as creating it. Reducing foreclosures through efforts such as counterbalancing loan risk should not be left to community-based organizations alone. Public officials and lending institutions should be actively involved in supporting actions that reduce the likelihood of a loan going from default to foreclosure. The costs of foreclosure go beyond the impact to the borrower. Preventing foreclosures is cost-beneficial and provides a public benefit.

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